SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 147

M. A. HOLMES,

Petitioner,

vs.

CHARLES J. McCOLGAN, AS BANK AND CORPORATION FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

Opinions of the Court Below.

The decision of the Supreme Court of the State of California in this cause denying petitioner's Federal right, rendered and filed on February 20, 1941, is found in the record at pages 19-24. It has not yet been officially reported but may be found in the California Advance Sheets, 17 A. C. 460 and in 110 Pac. (2) 428, and in the appendix to this brief.

Petition for rehearing in the cause by the Supreme Court of the State of California was filed, considered and denied without opinion on March 20, 1941 (R. 25).

Statement of the Case.

During 1933 and 1934 petitioner and certain of his children became the owners by discovery, location and purchase of a 60% undivided interest in mining property in Kern County, California, known as the Silver Queen, and of a mining lease covering a portion thereof. In November, 1934, for a cash consideration of $4,000.00, petitioner and his co-owners gave a sixty day option to purchase said 60% interest in the Silver Queen for $1,000,000.00 in money and $900,000.00 from the proceeds of the property to be paid on a graduated percentage schedule. Also in November, 1934, they gave a sixty day option to purchase the mining lease for $100,000.00. These options were exercised in January, 1935. The lease was transferred on January 11, 1935, and the 60% interest in the Silver Queen was conveyed on January 18, 1935. From the sales made the petitioner realized more than $100,000.00 in cash over his original investment (R. 3-7, 16).

On June 13, 1935, the first California Personal Income Tax Act (Calif. Stats. 1935, Chap. 329, p. 1090) became effective. It purported to tax as income all gains derived from sales of property, whether real or personal, received or accrued on and after January 1, 1935, and adopted by reference sections 111, 112, and 113 of the Federal Revenue Act of 1934 as the basis for computing gains realized from the sale of a capital asset. There was no increase in the value of the properties involved between December 31, 1934, and the respective dates in January, 1935, upon which the options to purchase were exercised and the properties were conveyed (R. 5-6, 6-7), but the respondent Franchise Tax Commissioner treated the difference between the cost of the properties and their selling price as income and levied a deficiency income tax assessment thereon for the calendar year 1935, which was paid by the petitioner under protest (R. 2-3).

Petitioner filed a complaint for the recovery of the amount of the deficiency tax paid, to which complaint respondent filed a general demurrer (R. 17). Said demurrer was sustained without leave to amend by the trial court, and judgment was rendered by it against petitioner and in favor of respondent (R. 18). Petitioner appealed from said judgment to the Supreme Court of the State of California and said Court affirmed said judgment. Petitioner seeks a review by this Court of the decision.

Summary of Argument.

The questions set forth in the Petition for a Writ of Certiorari present the constitutionality, under the Fourteenth Amendment to the Constitution of the United States, of two retroactive features of the first personal income tax law of the State of California relating to capital gains, all of which the demurrer to the complaint admits had accrued prior to January 1, 1935, the law's applicable date, and were realized thereafter but prior to the enactment of the law on June 13, 1935.

This Court has laid down two conditions precedent to the constitutionality of a retroactive feature of a tax law. These are (1) constitutional power to tax the gain, and (2) an existing established policy of taxing it. These two conditions are set forth in

MacLaughlin v. *Alliance Ins. Co.*, 286 U. S. 244, 76 L. Ed. 1083; and

Milliken v. *United States*, 283 U. S. 15, 75 L. Ed. 809.

The California Personal Income Tax Act of 1935 (the pertinent provisions of which are set forth in the appendix to this brief) was enacted June 13, 1935, and imposed a tax on all incomes received after January 1, 1935. All realized capital gains were taxed as income, including gains resulting solely from enhancement in value

prior to January 1, 1935, and subsequent to March 1, 1913.

When the aforesaid Act was adopted by the Legislature of California the first of the foregoing conditions precedent existed, as section 11 of Article XIII of the Constitution of California, adopted in 1879, granted the Legislature authority to assess income taxes.

But the second of the two conditions precedent, namely, an established policy of taxing incomes, did not exist. The Act in question was the first attempt by the State of California to tax individual incomes. No previous policy of taxing such incomes had been formulated or announced by the State, yet the Act includes in taxable income all accretions to capital over a period of more than twenty years prior to the date from which the Act was made applicable, provided only that such accretions be realized—not after the effective date of the Act—but after its applicable date, which is retroactively fixed as January 1, 1935, practically five and one-half months before the Act became a law.

Therefore the retroactive features of the Act do not meet the constitutional requirements laid down by this Court.

The proposition that the due process clause of the Fourteenth Amendment is violated by the provisions of the California Act under consideration is fully established by the analogy to certain gift and estate tax cases decided by this Court, commencing with *Nichols* v. *Coolidge*, 274 U. S. 531, 71 L. Ed. 1184. In that case it was held that the tax first imposed by the Revenue Act of 1918 was violative of due process in so far as it attempted to tax retroactively a transfer to a trustee in contemplation of death when such transfer was irrevocable and was made before the passage of the act, although the trustor died subsequently thereto.

In *Blodgett* v. *Holden*, 275 U. S. 142, 72 L. Ed. 206, it was held by a divided court (both opinions obtaining the same result) that *inter vivos* gifts made in January, 1924, before the passage of the Revenue Act enacted June 2, 1924, im-

posing a tax upon all gifts made during the calendar year 1924 and subsequently, were not subject to said tax. Later in *Untermyer* v. *Anderson,* 276 U. S. 440, 72 L. Ed. 645, this Court definitely declared that said Revenue Act of 1924 was unconstitutional in so far as it attempted to tax gifts made prior to its enactment, saying:

> "In the light of arguments advanced by counsel in the present cause the matter has been considered by all members of the court and a majority of them are of the opinion that the gift tax provisions of the Act of 1924 here challenged must be construed as applicable to gifts made during the entire calendar year 1924. And, further, that so far as applicable to bona fide gifts not made in anticipation of death and fully consummated prior to June 2, 1924, those provisions are arbitrary and invalid under the due process clause of the 5th Amendment.
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> "The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it * * *. The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken" (*Untermyer* v. *Anderson,* 276 U. S. 440 at 445-446, 72 L. Ed. 645 at 647).

Similarly, in *Coolidge* v. *Long,* 282 U. S. 582, 75 L. Ed. 562, this Court held that the State of Massachusetts could not constitutionally tax under its inheritance tax law, as a gift in contemplation of death, the trust involved in *Nichols* v. *Coolidge,* 274 U. S. 531, 71 L. Ed. 1184, *supra,* because when the trust was created no such law had been enacted, saying:

> "We conclude that the succession was complete when the trust deeds of Mr. and Mrs. Coolidge took effect, and that the enforcement of the statute imposing the excise in question would be repugnant to the contract clause of the Constitution and the due process clause of the 14th Amendment" (*Coolidge* v. *Long*, 282 U. S. 582 at 605-606, 75 L. Ed. 562 at 571).

Each of the foregoing four cases held that the retroactive provision of the law under consideration was violative of due process under the Federal Constitution, because it was an entirely *new law reaching a new subject of taxation*, not a law amending an existing system of taxation on the subject, and in each case the facts involved related to a transaction *entirely completed before the passage of the law.* Not only in each case did the law relate to a past and completed transaction, but it also imposed a tax that the taxpayer *could not have foreseen or anticipated* at the time he planned and completed the transaction. Furthermore, in each of these cases it was held that the act on the part of the taxpayer that resulted in the imposition of the tax *was a voluntary act*, that is, one he did not have to perform unless he wanted to, and one which he *had no warning or reason to foresee would later be made subject to the imposition of a new tax*—if he had, he might not have performed the act, or if he had decided to do so the warning would have given him an opportunity to have worked out some plan by which to have avoided the tax.

Milliken v. *United States*, 283 U. S. 15, 75 L. Ed. 809, *supra* (which held that the retroactive provision of the Estate Tax Law of 1918 was not unconstitutional) by its analysis of three of the foregoing cases and the distinction that it draws between the situation presented by them and that presented by the facts in that case but clarifies and strengthens the petitioner's position herein. That case related to the provisions of the Revenue Act of 1918 that

amended the Act of 1916 and increased the rates of tax over those set forth in the 1916 Act upon transfers of property made in contemplation of death. While the 1916 Act was in force a man gave to his children certain shares of corporate stock. The donor died in 1920, and the Commissioner included the shares of stock in the decedent's estate and taxed the value of the stock at the rates in the 1918 Act. The petitioners argued that the taxing statute as applied was a denial of due process of law because retroactive. In considering this contention this Court said:

> "This court has held the taxation of gifts made, and completely vested beyond recall, before the passage of any statute taxing them, to be so palpably arbitrary and unreasonable as to infringe the due process clause." (*Milliken* v. *United States,* 283 U. S. 15 at 20-21, 75 L. Ed. 809 at 814.)

The opinion then proceeds to analyze each of the four foregoing cases, except *Blodgett* v. *Holden,* in support of the quoted statement. It then calls attention to the fact that when the gift was made it was subject to the provisions of the 1916 Revenue Act. The opinion concludes with a statement of why, under the facts of the case and the provisions of the 1916 Act, the retroactive feature of the 1918 Act was not unconstitutional, in the following language:

> "It (the 1918 Act) is thus an enactment in aid of, and an integral part of, the legislative scheme of taxation of transfers at death. Decedent's gift as a substitute for a testamentary disposition was thus brought within the operation of the 1916 Act taxing such gifts on the same basis, with respect to rate and valuation, as transfers of property at death. Not only was the decedent left in no uncertainty that the gift he was then making was subject to the provisions of the existing statute, but in view of its well understood purpose he should be regarded as taking his chances of any in-

crease in the tax burden which might result from carrying out the established policy of taxation under which substitutes for testamentary gifts were classed and taxed with them.

"The reasonableness of the present application of the increased rate of tax of the 1918 Act must be determined in the light of the legislative policy which the 1916 Act had established before the gift was made. Obviously, that policy would be set at naught if gifts made in contemplation of death, after the 1916 Act, were to be taxed more favorably than transfers from the donor occurring at and by reason of his death * * * The decedent, when he made his gift, was as well warned that it might be taxed on that basis (of an estate passing at death) as he was that it would be so taxed if on that day he had made the same disposition of it by will. A change in the rate applicable to transfers at death necessitates a corresponding change in the rate applicable to gifts made in contemplation of death, else the purpose in taxing the latter would not be attained."

Milliken v. *United States*, 283 U. S. 15 at 23-24, 75 L. Ed. 809 at 815-816.

Point I.

The provision of the First Personal Income Tax Act of California making it apply to the gains upon a voluntary sale realized after the applicable date but before the effective date of the Act is unconstitutional.

All of the cases cited or discussed in the foreging Summary of Argument support the point above stated. We have not been able to find any case that disagrees with it except the instant decision of the Supreme Court of California.

The decision in question does not recognize or discuss this point in its entirety. The California Court fails to recognize the fundamental distinction existing between a

first tax law in a jurisdiction and an *amendatory* law. It loses sight of whether when the law under consideration was adopted there existed *an established policy of taxing* the thing in question. This is apparent from the fact that the only cases of this Court cited on this point are *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S. 1, 60 L. Ed. 493, embodying a quotation from *Stockdale* v. *The Insurance Companies,* 20 Wall. 323, 22 L. Ed. 348, and *Welch* v. *Henry,* 305 U. S. 134, 83 L. Ed. 87.

Stockdale v. *The Insurance Companies,* 20 Wall. 323, 22 L. Ed. 348, *supra,* did not involve a law taxing for the first time a new subject. This Court there had before it a section of the Act of 1870 "construing" certain sections of the Revenue Act of 1864. That the Act was amendatory of an existing established policy of taxation is apparent from the following statement in the opinion:

> "A critical view of the whole of the Statute of 1870 shows that it was designed to recast the internal revenue laws, to repeal some taxes, modify others, and declare the re-enactment or continuance of others for a limited time. And this was especially true of the class of taxes embraced under the general head of income taxes of all kinds."
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> *Stockdale* v. *The Insurance Companies,* 20 Wall. 323, 22 L. Ed. 348.

Welch v. *Henry,* 305 U. S. 134, 83 L. Ed. 87, *supra,* also involved a law amendatory of a long established policy of taxing incomes in Wisconsin. Even so the question arose as to whether the retroactive provision of this amendatory law was constitutional. The Supreme Court of Wisconsin thought it might "approach or reach the limit of permissible retroactivity", and the majority of this Court, quoting the statement, said "we cannot say that it exceeds it." While fundamentally distinguishable because the retroactive feature there in question was embodied in an amendatory law,

it recognizes the grounds enunciated in the gift tax cases hereinbefore considered for holding the retroactive application of a law placing a new tax on a new subject of taxation unconstitutional, and lays down some new tests of applicable interest here, none of which was given consideration by the Supreme Court of California.

The act involved was adopted by the Wisconsin Legislature on March 27, 1935, and amended the Wisconsin income tax law in force in 1933 so as to impose a tax on corporate dividends received in 1933 from corporations whose principal business was "attributable to Wisconsin," as the term was defined by the 1933 statute, that were not taxed by said statute. Thus the Act of 1935 taxed dividends received in 1933 that had escaped taxation at a time when other dividends and forms of income were being taxed.

This Court then reviewed the gift tax cases, and said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. Nichols *v.* Coolidge, 274 U. S. 531, 542, 71 L. Ed. 1184, 1192, 47 S. Ct. 710, 52 A. L. R. 1081; Untermyer *v.* Anderson, 276 U. S. 440, 445, 72 L. Ed. 645, 647, 48 S. Ct. 353 (citing Blodgett *v.* Holden, 275 U. S. 142, 147, 72 L. Ed. 206, 210, 48 S. Ct. 105); Coolidge *v.* Long, 282 U. S. 582, 75 L. Ed. 562, 51 S. Ct. 306. Since, in each of these cases the donor might *freely have chosen to give or not to give,* the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process. But there are other forms of taxation whose retroactive imposition cannot be said to be similarly offensive, *because their incidence is not on the voluntary act of the taxpayer.* And even a retroactive

gift tax has been held valid *where the donor was forewarned by the statute books of the possibility of such a levy.* Milliken *v.* United States, 283 U. S. 15, 75 L. Ed. 809, 51 S. Ct. 324, supra." (P. 147. Italics supplied.)

After stating that "In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid," this Court proceeded to state:

"Property taxes and benefit assessments of real estate, retroactively applied, are not open to the objection successfully urged in the gift cases. (Citing cases.) Similarly, a tax on the receipt of income is not comparable to a gift tax. We can not assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or to the increase of an old one." (Pp. 147 and 148.)

Further, it is said:

"*The equitable distribution of the costs of government* through the medium of an income tax is a delicate and difficult task. In its performance experience has shown the importance of reasonable opportunity for the legislative body, *in the revision of tax laws,* to distribute increased costs of government among its taxpayers in the light of present need for revenue and with knowledge of the sources and amounts of the various classes of taxable income during the taxable period preceding *revision.*" (P. 149. Italics supplied.)

Welch v. *Henry,* 305 U. S. 134 at 147-149, 83 L. Ed. 87 at 93.

From the last quotation it is evident that in deciding the case this Court kept in mind that it was dealing with an amendatory law. With that and the nature of the tax and the circumstances under which it was laid in mind, it would appear that the two controlling factors in the case were:

1. The receipt of the dividends involved was *not dependent upon the voluntary act of the taxpayer.* They were declared and paid without any exercise of choice or the making of any decision by him; and

2. The retroactive imposition of the tax *equalized* among all taxpayers the distribution of *the costs of government.*

Neither of these factors is present in the instant case. (1) It does not involve the receipt of any form of involuntary income such as dividends. The gains received were wholly dependent upon the *voluntary* act of the petitioner. (2) The *retroactive imposition of the tax did not equalize the distribution of the costs of government.* It did the very reverse, as it made petitioner pay taxes on income that had all accrued over a period of time during which all income actually received by others was wholly exempted from taxation.

Brushaber v. *Union Pacific R. R. Co.,* 240 U. S. 1, 60 L. Ed. 493, *supra,* is the only case cited by the California Supreme Court dealing with the retroactive feature of a tax law where an established policy of taxing did not already exist. However, a consideration of the underlying facts discloses the distinctions that render that decision inapplicable to the facts in the case of the petitioner. That case held that the Union Pacific Railroad Company should include in its income tax return for 1913 all income received after March 1, 1913. The facts present at least three fundamental distinctions: (1) The tax there involved applied to all taxpayers equally, being imposed in so far as capital gains were concerned on all such gains accrued *and* realized at any time after March 1, 1913. The tax under the Act here in question is imposed on capital gains accrued after March 1, 1913, *only* if such gains were realized *after* January 1, 1935, whereas similar gains which were realized *before* January 1, 1935, are not taxed. (2) The Railroad

Company was operating a transportation system. Its income arose from passenger fares and freight charges. *It did not involve realized capital gain.* Its transactions were *not separable voluntary transactions,* as the term is used in the tax cases. It could not have decided not to carry out any transaction in order to save the imposition of the tax. Petitioner's transaction was both *separable* and *voluntary,* and he could have saved the imposition of the tax if he had been given the opportunity. (3) The Railroad Company *had warning* in advance that such an act was about to be passed—it did not come as an unforeseen event, for the reason that the Sixteenth Amendment had been ratified before March 1, 1913, and it was public knowledge that it was adopted for the purpose of permitting the levying without apportionment of an income tax. The petitioner had no warning of the impending law, either when he gave the sixty day options in November, 1934, or when he received the money upon the completion of the transactions in January, 1935. The power (under the California Constitution) to impose such a tax, unused since 1879, instead of giving him warning, allayed, rather than aroused suspicion of immediate action.

Point II.

The provision of the First Personal Income Tax Act of California taxing income resulting from capital increment accrued prior to the date from which the Act was made applicable is unconstitutional.

A. *Such a Provision Is So Arbitrary and Capricious as to Amount to a Denial of Due Process of Law.*

The opinion of the Supreme Court of California gave no consideration to this second point. As heretofore stated, the Act under consideration was the first attempt by the State of California to tax individual incomes. The Act in-

cludes in taxable income all capital accretions that may have arisen since March 1, 1913, a period of more than twenty years prior to the applicable date of the Act. This is accomplished by incorporating by reference in Section 7 (d) of the Act, Sections 111, 112 and 113 of the Federal Revenue Act of 1934 (Appendix, *infra*, pp. 30-32) thereby making March 1, 1913, value, or subsequent cost, the basis upon which all capital gains shall be computed. No sound reason or basis is established for using the March 1, 1913, date. Under the Federal revenue acts that date was clearly adopted because it was the first convenient and reasonable date after the ratification of the Sixteenth Amendment, which was ratified February 25, 1913, and said March 1, 1913, date was established by the first Federal revenue act under the Sixteenth Amendment, which act was enacted October 3, 1913.

The petitioner does not object to the fact that the 1935 Legislature of California adopted the Federal *method* of computing capital gains and losses. What petitioner does object to is the very patent fact that in so doing the Legislature lost sight of the *manner* in which Congress applied the method. The manner in which Congress applied the method resulted in a reasonable law, just and fair to all taxpayers and, with respect to the aspect we are now considering, not unreasonably retroactive. While the work of the California Legislature resulted in a law so unreasonably retroactive that it is harsh, arbitrary and discriminatory.

If the *first* Income Tax Act of 1913 had been adopted by Congress on a basis similar to that of the California 1935 Act, Congress would have had to provide no change in the *method* of computing capital gains and losses, but only placed the date to which the method should apply back some twenty-two years to March 1st or January 1st, 1891. And Congress could have done so because during all that time

it possessed the *constitutional power* to tax incomes. The Sixteenth Amendment did not extend its taxing power; it simply removed the necessity for the apportionment among the States of income taxes, when levied. No court would have upheld such unreasonable retroactivity. The unconstitutionality of the retroactive feature would have been recognized by all. Nevertheless, that is exactly what the California Legislature did when it passed the Personal Income Tax Act of 1935, and that retroactive provision of the Act petitioner contends is unconstitutional.

On March 1, 1913, everyone knew that a Federal income tax law would be passed, as the Sixteenth Amendment had been ratified on February 25, 1913, and had been in the process of ratification and extensively discussed for some years prior thereto. All that remained to be done was to formulate and pass a law. No one was taken by surprise. Congress determined, such being the situation, that it would make its first Revenue Act include all income received after March 1, 1913. It went further and, in order to treat all types of income alike, it provided that capital gains that had accrued after March 1, 1913, when realized, should also be treated as income. But March 1, 1913, was the dead line. No accruals before that date were to be included, for the law provided that, in determining capital gains realized after March 1, 1913, the value of the property on March 1, 1913, must be used as the basis for computation. Consequently, a taxpayer with a capital gain, no matter how long it had been accruing, was not discriminated against, as only the accruals after March 1, 1913, were to be considered. He was placed on the same basis as a taxpayer who had held property for some years at a profit, but who sold it and realized his profit on February 28, 1913. He was placed on the same basis as a taxpayer who had his capital invested in stocks or bonds or notes and who received his income therefrom annually or at stated lesser

intervals, or as a taxpayer who was in business with a steady turnover, with resultant income and profits. There was no discrimination. No type or class of taxpayer was treated harshly. The Act's provisions were not arbitrary. As the succeeding years went by, the same condition continued. All were paying income taxes alike from and after March 1, 1913. If in 1930 a taxpayer sold a capital asset he had been holding since 1900 and, by reason of the long period, there was a large realized gain, he was treated fairly and protected under the law, as he was taxed only on the accruals after March 1, 1913, during which period he had been paying no taxes thereon, while his fellow taxpayers with investments that brought in annual returns had been paying taxes year after year during that period.

Had the *first* California income tax law been similarly drafted, using the established *method* of the Federal law, but not following that law slavishly or unreasonably by incorporating the March 1, 1913, date, but, instead, an analogously reasonable date from which to compute capital gains and losses, one occurring at least at some time after the bill for the Act had been introduced in the Legislature, the Act would not have been obnoxiously retroactive as relates to the aspect now under consideration.

As adopted, the harsh and discriminatory result of incorporating March 1, 1913, or subsequent cost, as the date from which to compute taxable gains, could not better be illustrated than by the facts of the instant case. Had the sale of petitioner's mining interests been concluded on December 31, 1934, the transaction would not have been subject to the California income tax. But because the transaction was not completed until January 18, 1935, the gains accrued prior to January 1, 1935, were subject to such tax, regardless of over how long a period they had been accruing, just so they had accrued since March 1, 1913.

Petitioner had no more knowledge of the impending tax when he delivered his deed and received his money on January 18, 1935, than he would have had if he had closed the transaction on December 31, 1934, and escape the tax, because not alone was no tax law in existence on January 18, 1935, the framework of the law had then not even been introduced in the Legislature—not until January 25, 1935, and no feature making it retroactive in any respect was introduced into the bill until March 14, 1935. (See Final Calendar of Legislative Business of California Legislature, Fifty-first Session (1935) under Assembly Final History, page 403 and File of Assembly Bills under Assembly Bill No. 1182.)

B. *Such Provision of the Act also Constitutes a Denial of the Equal Protection of the Laws.*

Petitioner, whose income resulted from accretions to capital over a period of years prior to the inception of the taxing act involved, is, under the Act, required to contribute to the cost of Government by a tax on such income, while others who may have received as much, or more, income over the same period by realizing on their capital assets prior to January 1, 1935, escape entirely from such tax. This provision of the Act does not accomplish an equitable distribution of the costs of Government, but the very reverse. The situation presented by the facts in the instant case are entirely different from those in *Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87, *supra*, where it was held that the retroactive taxation of a certain type of dividends that had previously escaped taxation when other types were being taxed did not constitute discrimination but resulted in an equitable distribution of the costs of Government.

There is no reasonable basis for the discrimination resulting from the provision of the California Personal Income Tax Act of 1935 under consideration, nor does the

Act undertake in any way to justify the same. The situation created by the Act as applied to the facts of the instant case, constitutes a denial to the petitioner of the equal protection of the laws.

POINT III.

The decision of the Supreme Court of California in this case is based upon a misconception and a misapplication by that court of the decisions of this Court.

Petitioner has pointed out in his Petition for a Writ of Certiorari that the cases of *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, 65 L. Ed. 751, and *Eisner* v. *Macomber,* 252 U. S. 189, 64 L. Ed. 521, referred to in the opinion of the Supreme Court of California in this case, do not sustain the constitutionality of a provision in the first tax law of a jurisdiction taxing as income an enhancement in the value of capital assets accruing before the applicable date of the law. In neither of those cases was an enhancement in value prior to March 1, 1913, involved.

Heretofore in this Brief, we have considered *Brushaber* v. *Union Pacific Railroad Co.,* 240 U. S. 1, 60 L. Ed. 493, and *Welch* v. *Henry,* 305 U. S. 134, 83 L. Ed. 87, also referred to in the California opinion as supporting the court's decision that the retroactive provisions of the California Act were constitutional.

The principal reliance of the Supreme Court of California in its decision of this case was upon the California case of *Fullerton Oil Co.* v. *Johnson,* 2 Cal. (2d) 162, 39 Pac. (2d) 796, which need not be discussed here further than to state that it is based upon a misconception and a misapplication of the case of *MacLaughlin* v. *Alliance Ins. Co.,* 286 U. S. 244, 76 L. Ed. 1083. That case held that under the Revenue Act of 1928 Congress was empowered to tax capital increment accruing after March 1, 1913, and realized in

1928. Such increment had been taxed under the Revenue Acts of 1913, 1916, 1917, and 1918 but was not taxed under the Revenue Acts of 1921, 1924 and 1926. The decision is clearly based upon the fact that Congress had theretofore established a policy of taxing such increment, and the earlier revenue acts had made March 1, 1913, the date from which such increment should be computed. This Court pointed out clearly what the California court missed, that in that case the question of taxing accretions in value occurring before March 1, 1913, was not involved. This Court said:

> "*Here there is no question of a tax on enhancement of value occurring before March 1, 1913,* the effective date of the Income Tax Act of that year, for the collector asserts no right to tax such increase in value. The fact that a part of the taxed gain, represented increase in value after that date, but before the present taxing act, is without significance. Congress, having constitutional power to tax the gain, *and having established a policy of taxing it,* see Milliken *v.* United States, 282 U. S. 15, 22, 23; 75 L. Ed. 809, 815, 816; 51 S. Ct. 324, may choose the moment of its realization and the amount realized, for the incidence and the measurement of the tax." (Emphasis supplied.)
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> *MacLaughlin* v. *Alliance Ins. Co.,* 286 U. S. 244, 250, 76 L. Ed. 1083, 1086.

This Court also pointed out in the foregoing quotation that in the *MacLaughlin* case Congress had, long before the passage of the act there in question, established a policy of taxing similar increases in value. The act was simply amendatory of the long established policy. No such policy existed in California at the time of the enactment of the Personal Income Tax Act of 1935.

These misconceptions with respect to the situation in and the holding of the *MacLaughlin* case are responsible more than anything else for what petitioner deems to be the er-

roneous views of the Supreme Court of California upon the constitutionality of certain provisions of the State's first Personal Income Tax Act. To rectify and avoid the perpetuation of the misconception and misapplication of the decisions of this Court in the *MacLaughlin* and other cases by the Supreme Court of California the petitioner submits that it is necessary that this Court review the instant case.

POINT IV.

The decision of the Supreme Court of California in this case is in conflict with the decisions of the courts of last resort of other States.

We have pointed out in the petition that the decisions of the courts of last resort of Wisconsin and Georgia are in conflict upon a similar state of facts with the decision of the Supreme Court of California in this case. See *State* v. *Nygaard*, 163 Wis. 307, 158 N. W. 87; *Norman* v. *Bradley*, 173 Ga. 482, 160 S. E. 413, and *State Revenue Commission* v. *Lazear*, 179 Ga. 167, 175 S. E. 451.

In Massachusetts the case of *Trefry* v. *Putnam*, 227 Mass. 522, 116 N. E. 904, arose under the first income tax law of the State enacted in 1916 under authority of a constitutional amendment ratified in November, 1915. The statement on the subject here in question was *dictum*, since it was made in connection with a discussion respecting dividends declared and paid *after* the effective date of the law, but it is pertinent and indicates the trend of the Supreme Judicial Court of Massachusetts on the subject. The court said:

> "A very different question would arise if the attempt were made to tax as income the increase in value of the capital investment in intangibles which had accrued to the owner from a date of purchase long anterior to the enactment of the tax act. Such a construction of a statute would not be adopted except as

the imperative result of unequivocal words, *and even then serious questions might arise as to the validity of such an act.*" (Emphasis supplied.)

Trefry v. *Putnam*, 227 Mass. 522, 116 N. E. 904 at 909.

We have been unable to find any State where the court of last resort has held upon a similar state of facts in harmony with the decision of the Supreme Court of California in the instant case. The petitioner submits that in view of this situation a decision of this Court in this case is desirable in order to establish uniformity of decisions and in order to determine the correct rules for the legislatures and courts of the respective States to follow, and that it is in the interest of public welfare that the existing uncertainty be removed.

Conclusion.

It is respectfully submitted that for the protection of the constitutional rights of the petitioner, as well as those of other taxpayers similarly situated, this Court should review the above cause as prayed in the petition for a writ of certiorari to which this brief is appended.

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